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Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-08 NSC-05
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COME-00 FRB-03 INR-10 NSAE-00 XMB-02 OPIC-03
LAB-04 SIL-01 L-03 H-01 PA-01 AGRE-00 DOE-11
SOE-02 /104 W
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P 171530Z MAR 78
FM AMEMBASSY BERN
TO SECSTATE WASHDC PRIORITY 5947
INFO AMEMBASSY PARIS PRIORITY

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PASS TREAS AND FRB

EO 11652: NA
TAGS: ECON EFIN SZ
SUBJ: SWISS ECONOMY: REVIEW OF 1977 AND OUTLOOK FOR 1978

1. BEGIN UNCLAS: SUMMARY: AFTER DEEP 1975 RECESSION AND 1976 STAGNATION, SWISS ECONOMY IMPROVED IN 1977 WITH 4.3 PERCENT REAL GROWTH IN GNP TO $63.7 BILLION, STIMULATED BY INCREASED EXPORTS, PRIVATE CONSUMPTION AND FIXED CAPITAL INVESTMENT. KEY FACTORS WERE STABLE SWISS FRANC AND LOW INFLATION WHICH HELPED EXPORTS COMPETE FOR STRONGER EXPORT DEMAND. MODEST 1977 TRADE DEFICIT REFLECTED IMPROVED ECONOMIC GROWTH BUT WAS INSUFFICIENT TO OFFSET LARGE SURPLUS ON INVISIBLE TRANSFERS. HOWEVER, PROSPECTS FOR 1978 ARE DIMMER AS RESULT CONTINUED SF APPRECIATION, DECLINING DEMAND FOR EXPORTS AND DECREASED INVESTMENT. OUR FORECAST IS FOR REAL GNP GROWTH OF UNDER 2 PCT. WE BELIEVE THAT DESPITE LOW INFLATION RATE AND EVEN LOWER INTEREST RATES, ANTICIPATION OF POORER EXPORT
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PERFORMANCE WILL RESULT IN LEVEL OF NEW INVESTMENT INADEQUATE TO GENERATE HIGHER GROWTH RATE. GOVT WILL FOLLOW CONSERVATIVE ECONOMIC POLICIES BUT MAY PROVIDE TAX RELIEF IF ECONOMY FALTERS BADLY ENOUGH TO GENERATE POLITICAL PRESSURE FOR STIMULATION IN 1978 AS PARLIAMENTARY ELECTIONS APPROACH. END SUMMARY.

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2. EXPORTS OF GOODS AND SERVICES IN 1977 (35.3 PCT
OF GNP) ROSE 13.8 PCT, 10.6 PCT IN REAL TERMS.
SF EXCHANGE RATE STABILITY AND LOW INFLATION KEPT
SWISS EXPORTS COMPETITIVE; EXPORT PRICES ROSE
AVERAGE 1.8 PCT. FURTHER EC TARIFF REDUCTION IN
JUL WAS ADDED FACTOR. INDUSTRIAL PRODUCTION ROSE
ABOUT 4 PCT BUT PERFORMANCE VARIED CONSIDERABLY EVEN
WITHIN INDUSTRIES. CAPACITY UTILIZATION ROSE
SLIGHTLY TO 80 PCT AS RAW MATERIAL IMPORTS INCREASED
17.7 PCT. MOST EXPORT GROWTH WAS IN NON-TRADITIONAL
AREAS: METALS, CONSUMER PRODUCTS AND SERVICES
(ENGINEERING); KEY BRANCHES OF TEXTILES, CLOTHING
AND CHEMICALS HAD ONLY MODERATE GROWTH; ELECTRONIC
WATCH EXPORTS ROSE; MACHINE EXPORTS (TRADITIONAL
LEADER) ROSE ONLY IN LATE 1977. MOST FIRMS REPORTED
THIN PROFIT MARGINS; THE LARGER FIRMS DID BETTER.

3. NOMINAL IMPORTS AND EXPORTS REACHED RECORD
LEVELS IN 1977, AVERAGE 11 PCT GROWTH EXPECTED IN 1978.
FASTER IMPORT GROWTH (16.7 PCT) RESULTED IN MODEST
TRADE DEFICIT $361.6 MILLION, COMPARED TO 1976
SURPLUS $69.4 MILLION, COMPARED TO 1976
SURPLUS $69.4 MILLION. ESTIMATED 1977 CURRENT ACCT
SURPLUS WAS $3.5 BILLION, MOSTLY FROM RETURNS
ON FOREIGN LOANS AND INVESTMENTS. WE FORECAST A
SIMILAR TRADE DEFICIT BUT LARGER
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CURRENT ACCT SURPLUS FOR 1978.

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PASS TREAS AND FRB

4. FIXED CAPITAL INVESTMENTS (20 PCT OF GNP)
ROSE 5.8 PCT IN 1977; NEW EQUIPMENT PURCHASES
INCREASED 8.2 PCT; CAPITAL GOODS IMPORTS 21.2 PCT.
CONSTRUCTION FOR INDUSTRIAL RESTRUCTURING GREW
4.6 PCT. NEW CONSTRUCTION STAGNATED; NEW BUILDING
LOANS ROSE 1.7 PCT, CHIEFLY FOR SINGLE FAMILY
DWELLINGS. CONSTRUCTION MAY DECLINE 2 PCT IN REAL
TERMS IN 1978; EQUIPMENT PURCHASES MAY GROW 5 PCT.

5. NOMINAL 1977 PRIVATE CONSUMPTION (60 PCT OF GNP)
GREW 4 PCT, CHIEFLY DUE TO PURCHASES OF DURABLES:
NEW CAR SALES ROSE 20 PCT. ALSO, POPULATION TENDED
TO STABILIZE; FEWER FOREIGN WORKERS LEFT THAN IN
PREVIOUS YEAR. CONSUMPTION SHOULD GROW AT SAME
PACE OVERALL IN 1978 BUT AT LOWER RATE FOR DURABLES.

6. AVERAGE UNEMPLOYMENT RATE IN 1977 WAS 0.5 PCT.
INDUSTRIAL RATIONALIZATION PLANS MAY CAUSE INCREASED
UNEMPLOYMENT DUE TO LABOR IMMOBILITY; HOWEVER, TEXTILE
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FIRMS AND HOTELS ARE EXPERIENCING LABOR SHORTAGES.

7. GOVT AND NATL BANK POLICIES AIM AT MODERATE
MONETARY EXPANSION (M1 GROWTH RATE TARGET OF 5 PCT IN
1977 AND 1978) TO CREATE CLIMATE CONDUCIVE TO NEW
INVESTMENTS AND MORE RAPID REAL GROWTH WITHOUT FUELING
INFLATION. SWISS MONEY SUPPLY (M1) EXPANDED BY 5.5
PCT IN 1977. CONSUMER PRICE INDEX ROSE 1.3 PCT IN
1977 AFTER 1.7 PCT RISE IN 1976 DUE TO IMPACT OF
APPRECIATED SF ON IMPORTS. SIMILAR INFLATION RATE
IS EXPECTED IN 1978 WITH ONLY SLIGHT REAL WAGE
INCREASE. FINANCIAL MARKETS ARE SUFFICIENTLY LIQUID
TO FINANCE 4 PCT GROWTH IN 1978 CONSUMER DEMAND.
VOTERS RECENTLY PASSED LAW FORMALIZING GOVT ECONOMIC
POLICY POWERS. GOVT HAS DRAFTED NEW NATL BANK LAW
PROVIDING IMPORTANT POLICY TOOLS.

8. SUBSTANTIAL CAPITAL MAKRET LIQUIDITY CAUSED
SHORT AND LONG TERM INTEREST RATES TO DROP AS MUCH
AS 15 PCT IN 1977; MEDIUM TERM RATES FELL 35 PCT.

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CREDIT GREW 9.2 PCT FROM END 1976. BANK DEPOSITS
WERE UP 9.2 PCT, COMPARED 12.4 PCT IN 1976. INTEREST
RATES HAVE FALLEN FURTHER IN FIRST QURTER 1978.

PUBLIC AUTHORITIES HAVE REFRAINED FROM BORROWING.

9. SF APPRECIATED 17.1 PCT IN 77 ON TRADE-WEIGHTED
BASIS BUT 21.3 PCT AGAINST US DOLLAR, CHIEFLY IN
LAST TWO MONTHS. SNB BOUGHT FOREX ESTIMATED AT
$9.3 BILLION IN 77 TO EASE PRESSURE ON SF, OFFSET
BY $7.6 BILLION IN CAPITAL EXPORTS. SNB'S MARKET
INTERVENTIONS INCREASED IN SECOND HALF 77 WHEN
DOWNWARD PRESSURE ON DOLLAR INCREASED. FOREX
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DEALERS EXPECT CONTINUED UPWARD PRESSURE ON SF DESPITE
FEB 78 MEASURES TO BAR CAPITAL INFLOWS. SNB WILL
CONTINUE FOREX PURCHASES AND, IF NECESSARY, WILL
TEMPORARILY ABANDON MONEY SUPPLY GROWTH TARGET.

10. AGRIC PRODUCTION IN 77 WAS $2.8 BILLION,
ONE PCT BELOW 76. OUTPUT IS FORECAST TO RISE 4.6
PCT IN 78 TO 4.5 PCT GNP. SWISS AGRICULTURAL
POLICIES ARE EXPECTED TO CONTINUE EMPHASIS ON
IMPORT RESTRICTIONS AS MAJOR MEANS OF SUPPORTING
GREATER PRODUCTIVITY IN SECTORS STILL BELOW SELF-
SUFFICIENCY LEVELS.

11. FORECAST FOR 1978: REAL GNP GROWTH MAY BE
UNDER 2 PCT, THOUGH NOMINAL GROWTH MAY BE 3.8 PCT,
DUE TO PROSPECT OF SLOWER EXPORT GROWTH AND REDUCED
INVESTMENTS. GOVT ENDED MODEST STIMULATION SPENDING
PROGRAMS IN 77; ADOPTED POLICY OF REDUCED EXPENDITURES
IN 78; PLANS INCREASE REVENUES TO EVENTUALLY
BALANCE BUDGET BY ADOPTING VALUE ADDED TAX OF
OF 8 PCT IN 79. MOST OFFICIALS BELIEVE THERE LITTLE
PROSPECT FOR EFFECTIVE NEW STIMULATION MEASURES;
OPPOSE OVER-EXPANDING MONEY SUPPLY; BELIEVE THOSE
POLICIES WOULD REKINDLE INFLATION AND DELAY NEEDED
INDUSTRIAL RATIONALIZATION TO OVERCOME STRUCTURAL
WEAKNESSES. WE BELIEVE THAT SWISS OVER-EMPHASIZE
DEPENDENCE ON EXPORT MARKET BUT THAT SO LONG AS SF
CONTINUES APPRECIATE, WILL PURSUE HYPER-CAUTIOUS
POLICY TO PREVENT INCREASES IN EXPORT PRICES FROM ANY
OTHER CAUSE, E.G., INFLATION.

12. PRIVATE ECONOMISTS LAST YEAR CRITICIZED BAD
TIMING OF GOVT POLICIES. SAID EFFORTS TO REDUCE
FOREIGN POPULATION AND BALANCE BUDGET WORSENED
RECESSION AND DELAYED RECOVERY; SAID MONETARY POLICY

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EXACERBATES SF APPRECIATION BY HOLDING DOWN INFLATION
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(77 BERN 6001). GOVT HAS PROPOSED $16 MILLION PROGRAM
TO ASSIST SELF-HELP MEASURES IN ECONOMICALLY DEPRESSED
REGIONS AND UP TO $43 MILLION TO STIMULATE INDUSTRIA
R AND D. THOSE PROGRAMS WOULD HAVE MINOR IMPACT.
SOME OFFICIALS SUGGEST GOVT WOULD PROVIDE MEASURE OF
FISCAL RELIEF IN 78 IF ECONOMIC GROWTH FALTERS.

13. SWISS EXPECT OECD ECONOMIC REVIEW WILL CRITICIZE
BOP SURPLUS AND URGE INCREASED FOREIGN ASSISTANCE.
SWISS $26 MILLION PARTICIPATION IN CIEC SPECIAL
ACTION PROGRAM HAS BEEN FINALIZED. GOVT SENT
PARLIAMENT $397 MILLION FOREIGN ASSISTANCE PGORAM
FOR 30-MONTH PERIOD BEGINNING JULY 178, COMPARED TO
$100 MILLION IN PREVIOUS 14 MONTH PERIOD. SWISS
RECOGNIZE THEIR PUBLIC FOREIGN AID AT 0.2 PCT OF
77 GNP WELL BELOW AVERAGE 0.33 PCT FOR DAC COUNTRIES
BUT BELIEVE THAT IN FACE POPULAR OPPOSITION CANNOT
INCREASE AID MORE THAN 0.01 PCT ANNUALLY IN COMING
YEARS. GOVT BELIEVES CURRENT HIGHLY CONSERVATIVE
ECONOMIC POLICIES ARE FULLY SUPPORTED BY SWISS
CITIZENRY. VOTES IN RECENT REFERENDA SUGGEST GOVTS
VIEW IS CORRECT. BEGIN LOU: ONLY EXCEPTION IS DEFENSE. SWISS
ARE CONCERNED BY WHAT THEY CONSIDER LACK OF PROGRESS
AT BELGRADE AND CONTINUED ADVANCE OF LEFT AND/OR
COMMUNISTS IN NEIGHBORING COUNTRIES. THEIR WILLING-
NESS TO ALLOCATE MORE RESOURCES TO SUPPORT POLICY
OF ARMED NEUTRALITY REFLECTS THAT CONCERN. END LOU
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